shares of stock from *American*, and, on January 24, 1955, petitioner acquired the said shares from *Sutro* upon payment of the purchase price and agent's commission (R. 5a).

In re Dividends

As has been seen, the fifth paragraph of the agreement of sale of the said stock provided as follows:

> "If the transaction is consummated as herein provided, all dividends paid or payable on the said stock after the date hereof shall be your property and shall be paid over at the time of payment of the purchase price, but without liability for interest thereon."

The facts are:

Over a month prior to the execution of the agreement, to wit, on October 29, 1954, *General* had declared cash dividends amounting to sixty cents per share, payable on December 31, 1954, to stockholders of record on December 20, 1954; and these dividends, amounting to $31,800.00 on the 53000 shares involved in this case, were, on December 31, 1954, duly paid to and accepted by *American*, because, as above stated, the agreement of sale had not been consummated at that time, and therefore *American* was still, at that time, the legal and record owner of the stock.

But when the sale of the stock was consummated, as aforestated, the said amount of $31,800.00 of dividends was, in accordance with paragraph fifth of the agreement of sale, "paid over" to petitioner.

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de facto one, on December 7, 1954, when the agreement was executed.

More fully, it has been stipulated as follows (R. 5a, par. 6):

> "6. Petitioner paid for the 5300 shares of General stock by checks delivered to Sutro on January 24, 1955 and January 25, 1955, for $1,060,000.00 plus broker's commission. On January 26, 1955, Sutro delivered its check to petitioner for $31,800.00 representing the dividends paid by General to American on December 31, 1954."

Consequently, when petitioner filed its income tax return for the year 1955 petitioner reported the receipt of the $31,800 dividend as ordinary income, and claimed the benefit of a dividends-received reduction of 85% thereof, in accordance with the provisions of section 243 of the Internal Revenue Code of 1954, *supra*.

But, as it turned out, when *American* filed its returns it laid claim to the same credit.

More fully, it has been stipulated that "*American* reported the $31,800.00 as a dividend received on its income tax return for the year 1954" (R. 5a, par. 4); and in its return for 1955 it "reported that the sale took place on January 18, 1955, and that it received $1,028,200.00 as proceeds of the sale". (R. 5a, par. 7).[3]

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[3] It is true that in the settlement between Sutro and American the transaction was simplified by Sutro's paying to American the amount of the stipulated purchase price of the stock ($1,060,000) less the amount of the dividend of $31,800, or only $1,028,000 (R. 5a, par. 5; 7a) but apparently this short cut was not regarded by the Government as being significant because in the answer filed to the petition it was admitted that the agreement of sale of the stock ". . . was executed in accordance with the terms thereof" (R. 3a, par. e) which can only mean that the $31,800 dividend was actually "paid over" to petitioner at the time of settlement.

Faced with this conflict in the returns, respondent, in effect, aligned himself with *American*. That is to say, respondent, at least temporarily,[4] accepted the returns filed by *American*, and rejected the returns filed by petitioner; and, on that basis, respondent determined a deficiency in the tax paid by petitioner for the year 1955 in the amount of $14,055.60. On appeal to the Tax Court of the United States, respondent's determination of deficiency was sustained, and judgment[5] was entered accordingly (R. 17a). The opinion of the Tax Court covers a lot of ground, but in essence it lays down a general rule that no one other than an actual stockholder on the record date can be regarded as the recipient of a dividend as taxable income. For example, the court said (R. 14a):

> "* * * In pertinent part, section 316(a) defines 'dividend' as any distribution of property made by a corporation *to its shareholders* out of its earnings and profits. If petitioner was a shareholder on the record date, December 20, 1954, prescribed by General's declaration of the dividend here in controversy, it is entitled to the deduction. If not, it is not so entitled.
>
> * * * * * * *
>
> "* * * We cannot agree that the $31,800 payment made by American to petitioner constituted the payment of a dividend for the reason that we cannot

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[4] Petitioner is informed that respondent has taken all necessary steps to keep open the way to assert a claim against *American* if his claim against petitioner proves unsuccessful.

[5] Because of stipulated adjustments, judgment was entered by the Tax Court in the amount of $4,486.28 (infra, p. 17a).

Jurisdiction of the Tax Court was invoked under section 7442 of the Internal Revenue Code of 1954 (26 U.S.C., sec. 7442).

conclude from the record that petitioner was either a shareholder of General or actual owner of the stock on the record date prescribed by the declaration of the dividend in question."

The decision of the Tax Court was affirmed by the United States Court of Appeals for the Third Circuit, but on different ground. That is to say, the latter court based its decision solely on the fact that at the time when *American* received the dividend it was still uncertain whether or not the agreement of sale would be carried out (*infra*, p. 25).

ARGUMENT

REASONS FOR GRANTING THE WRIT

1.

The decision of the court below is in substantial conflict with decisions rendered by the courts of appeals for the 2nd and 7th circuits.

2.

"* * * consistency of decision in the federal tax field is indispensable for taxpayers and their advisors who need to predict the tax consequences of their transactions." (Per Finnegan, circuit judge, in *Miller v. Commissioner of Internal Revenue*, 247 F. 2d 206-07, cir. 7th, 1957.)

3.

As stated by Mr. Justice Douglass in a concurring opinion:[6] "* * * The Revenue laws have become so complicated and intricate that * * * the Government in moving against the citizen should * * * turn square corners * * *", whereas, in cases of this kind, the Government has been playing fast and loose to a deplorable extent.

AUTHORITIES

The cases in conflict with the decision below are: *DeGuire v. Higgins*, 159 F. 2d 921 (C.A. 2d Cir. 1947), cert.

[6] *Commissioner v. Lester*, 366 U.S. 299, 306 (1961).

den., 331 U.S. 858; *Northern Trust Co. of Chicago v. United States,* 193 F. 2d 127 (C.A. 7th Cir. 1952), cert. den., 343 U.S. 956; *Miller v. Commissioner of Internal Revenue,* 247 F. 2d 206 (C.A. 7th Cir. 1957), cert. den., 355 U.S. 939, rehearing denied, 356 U.S. 956.

In each of the above cited cases there was involved (1) an executory agreement of sale of stock, (2) receipt by the seller of a dividend between the date of the agreement and the date of performance and (3) application of the amount of the dividends in reduction of the purchase price; and in each case the Court of Appeals held that the dividend constituted ordinary taxable income to the buyer, and not to the seller, and that, therefore, for the purpose of calculating capital gains or losses, the amount of the stipulated purchase price remained unaffected.

The decision below is the only appellate court decision holding, in substance or effect, that such dividends constitute taxable income to the seller.

Analysis shows that even up to the time when, in the year 1957, the last of the above cited cases was decided, viz, *Miller v. Commissioner of Internal Revenue,* supra, the Government seemed to lean strongly to the position that such dividends should be taxable to the seller, but still the Government has seemed always to waver between the two possible points of view. For example, in the opinion rendered in the *Miller* case the Court of Appeals took occasion to say (247 F. 2d at page 207):

> "* * * That the dividend was taxable to the seller was the chief contention of the Commissioner who, as he asserts through his brief, 'being charged

with the duty of collecting the revenue is occasionally required to take inconsistent positions in order to conform to his duty. The present consolidated proceeding presents such a problem. The Commissioner believes the Tax Court was correct and would not have appealed in the case of the buyers had not the seller filed a petition for review.' In short, we are told this 'dividend was inexorably income to someone'. Accordingly, the Commissioner filed a protective appeal against the buyers * * * "

Notwithstanding that in the above-quoted case the decision of the Court of Appeals was adverse to the Commissioner's contentions, no effort was made by the Commissioner to obtain a review of the court's conclusions, but, on the contrary, the Commissioner in this Court filed a brief in opposition to the buyer's petition for a writ of certiorari, and in this brief the Commissioner said (pp. 9-10):

" * * * While we believe that the Tax Court's conclusion that the seller remained the beneficial owner of the stock is a reasonable one (since at the time of the dividend the seller not only retained legal title but the right to vote the stock) and so contended in the court below, it cannot be said that the contrary interpretation adopted by the Court of Appeals is not also a permissible one."

It therefore appears that unless and until this Court settles the law involved in this sort of case the Government will not be able to see the way clearly enough to enable it to perform its duty of turning "square corners" in enforcing the income tax laws in this respect.

The gist of the opinion of the Court of Appeals is the statement that (*infra* p. 25):

> "* * * the agreement to sell — and buy — was based on a contingency which might never have materialized, and such an agreement does not vest any rights—beneficial or otherwise—until the materialization of the contingent event. * * *"

It would seem obvious, however, that there is no point in talking about what "might never have materialized". To be sure, the agreement was made subject to the happening of a contingent event; but, since the event actually occurred, resulting in complete performance of the agreement, the fact that the agreement was originally contingent becomes a matter of no consequence from any practical or substantial point of view.

The court below concluded that (*infra*, p. 25):

> "* * * The hard fact is that what the petitioner here labels a 'dividend' was actually an allowance in reduction of cost of stock."

But, as has been seen, the cases hereinbefore cited from the second and seventh circuits hold that even when the contract expressly provides that the dividends shall be applied to reduction of the purchase price the amount of such dividends constitutes income to the purchaser, and surely this should be none the less true in a case where, as here, the contract provides that the dividends shall be regarded *absolutely* as the purchaser's property.

CONCLUSION

For the reasons hereinabove stated, this petition for a writ of certiorari to the United States Court of Appeals for the Third Circuit should be granted.

Respectfully submitted,

FRANCIS T. ANDERSON,
Attorney for Petitioner.

APPENDIX A

UNITED STATES COURT OF APPEALS
For the Third Circuit

No. 13,676

Joseph L. O'Brien Co.,
Petitioner

v.

Commissioner of Internal Revenue

On Petition for Review of the Decision of the Tax Court of the United States

Argued December 21, 1961
Before McLaughlin, Kalodner and Hastie, *Circuit Judges*

OPINION OF THE COURT

(Filed April 9, 1962)

By Kalodner, *Circuit Judge*

The petitioner, Joseph L. O'Brien Co., filed this petition to review the decision of the Tax Court[1] which re-

[1] Reported at 35 T.C. 750 (1961).

jected its contention that it was entitled to a dividends-received deduction for 1955 under the provisions of the Internal Revenue Code of 1954.[2]

The single issue presented is whether petitioner was the beneficial owner of stock on the record date on which a certain dividend was declared payable under the terms of a contingent contract of sale entered into prior to that date and consummated thereafter.

The facts as stipulated and found by the Tax Court are substantially as follows:

The petitioner is a corporation organized on December 22, 1954, under the laws of Pennsylvania. Its first income tax return was for the period December 22, 1954, to December 31, 1954. Thereafter its returns were filed on a calendar year cash basis. The taxpayer's return for the year 1955, the year involved herein, was filed with the District Director of Internal Revenue at Philadelphia, Pennsylvania. Accompanying the filing of its first return was a letter to the Director which contained the following:

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[2] The relevant provisions of the Internal Revenue Code of 1954 provide as follows:

"§243. Dividends received by corporations.

"(a) General Rule.—In the case of a corporation, there shall be allowed as a deduction an amount equal to 85 percent of the amount received as dividends (other than dividends described in paragraph (1) of section 244, relating to dividends on the preferred stock of a public utility) from a domestic corporation which is subject to taxation under this chapter."

"§316. Dividend defined

"(a) General Rule.—For purpose of this subtitle, the term 'dividend' means any distribution of property made by a corporation to its shareholders—

"(1) out of its earnings and profits accumulated after February 28, 1913, . . ."

"This Corporation was organized under the laws of the State of Pennsylvania on December 22, 1954. From that date to December 31, 1954, there were no Assets or Liabilities acquired and there was no business transacted which would reflect Income or Expenses."

On December 7, 1954, American Locomotive Company ("American") wrote to Sutro Brothers & Company, stockbrokers ("Sutro"), to confirm an understanding regarding the proposed purchase by Sutro from American of 53,000 shares of the outstanding common stock of General Steel Castings Corporation, a Delaware corporation ("General"), as follows:

"December 7, 1954

"Sutro Brothers
120 Broadway
New York, N. Y.

"Gentlemen:

"This will serve to confirm our understanding with you relative to your purchase of 53,000 shares of the outstanding common stock of General Steel Casting Corporation, of which we are now the owner.

"Subject to the provisions set forth below, we agree to sell such shares to you, and you agree to buy the same from us, at a purchase price of $20.00 per share, making an aggregate purchase price of $1,060,000. It is understood that no commissions will be payable by us in connection with this transaction, and by acceptance of this letter you agree to indemnify us for liability of any such commissions.

"As we have advised you, an opinion has been requested from the Securities Exchange Commission to

the effect that the sale of these shares by us will not require the filing of a registration statement under the Securities Act of 1933, as amended. We hope to obtain a so-called 'no action' letter in this regard from the Securities Exchange Commission sometime next week. It is understood that upon our receipt of such a 'no action' letter on or before December 28, 1954, we shall deliver on not less than two, and not more than three, business days notice to you after such receipt a certificate or certificates for the shares referred to above, duly endorsed for transfer and with federal and state transfer stamps attached, to you and that you will pay us the purchase price therefor. If a 'no action' letter is not received on or before the date mentioned above, we will request General Steel Castings Corporation to file an appropriate registration statement and to comply with the other requirements of the Securities Act of 1933 to the end that the purchase and sale of the above securities may be legally consummated. If such a registration statement is so filed and becomes effective within the time limit hereinafter set forth, we will deliver the certificate or certificates for the above-mentioned shares, duly endorsed for transfer and with federal and state transfer stamps attached, to you against receipt of the purchase price therefor on two business days notice to you but not later than three business days after the effective date of the registration statement.

"If a 'no action' letter is not received from the Securities Exchange Commission on or before December 28, 1954, and if a registration statement as aforesaid with respect to these securities fails to become

effective on or before April 15, 1955, this agreement shall become ineffective and there shall be no further rights or liabilities on the parts of either of us because of the transaction covered hereby.

"If the transaction is consummated as herein provided, all dividends paid or payable on the said stock after the date hereof shall be your property and shall be paid over at the time of payment of the purchase price, but without liability for interest thereon.

"If it becomes necessary to file a registration statement in order to consummate the transaction, you will pay interest to us on the purchase price ($1,060,000) at the rate of 3% per annum from December 28, 1954 to the date of delivery. Such interest will be payable to us on such delivery date.

"If the foregoing meets with your approval kindly indicate your assent by signing the endorsement at the foot of this letter and returning the same to us, retaining the copy for your files.

Very truly yours,
American Locomotive Company
By (s) Herman Press
Treasurer

"Accepted.
December 7, 1954
Sutro Brothers
By (s) Charles A. Bezer"

Previously, on October 29, 1954, General had declared a regular dividend of 30 cents per share and an extra dividend of 30 cents per share on its common stock. The dividends were declared to be payable and actually were

paid on December 31, 1954, to stockholders of record on December 20, 1954. The dividends on the 53,000 shares in question, totaling $31,800 were paid to American, which was the stockholder of record on December 20, 1954. American reported the $31,800 as a dividend received on its income tax return for the year 1954.

The Securities and Exchange Commission under date of January 11, 1955, issued a "no-action" letter to American in regard to the proposed sale of 53,000 shares of General common stock. The sale of this stock was consummated on January 18, 1955 in the manner described in a letter of that date addressed by W. J. Bolte of American to William McDermott, attorney for the taxpayer, as follows:

> "The sale of 53,000 shares of common stock of General Steel Castings Corporation by our Company to Sutro Bros. & Co. was closed today at this office in accordance with the letter agreement of December 7, 1954 between our Company and Sutro Bros. & Co. and my subsequent conversations with you.
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> "At the closing we delivered to representatives of Sutro Bros. & Co. certificates representing the 53,000 shares of stock, to which the necessary Federal and State stamp taxes had been duly attached and cancelled; and accompanied by stock powers executed on behalf of our Company and certified copies of Resolutions evidencing the authority of the President of our Company to sell such shares and the authority of the Treasurer to sign the necessary endorsements to effect their transfer. The representatives of Sutro Bros. & Co. handed us a certified check for $1,028,200. representing the $1,060,000 purchase price of the

shares less the $31,800 dividend (30¢ regular and 30¢ extra) which we had received on the shares on December 30, 1954. They also handed us a receipt for the stock certificates. This closes the transactions contemplated by the December 7, 1954 letter agreement."

Sutro purchased these shares as agent for the taxpayer.

The taxpayer paid for the 53,000 shares of General stock by checks delivered to Sutro on January 24, 1955, and January 25, 1955, for $1,060,000 plus broker's commission. On January 26, 1955, Sutro delivered its check to the taxpayer for $31,800, representing the amount of the dividends paid by General to American on December 31, 1954.

American reported the sale of the 53,000 shares on its income tax return for the year 1955. It reported that the sale took place on January 18, 1955, and that it received $1,028,200 as proceeds of the sale.

At all pertinent times General was a domestic corporation, subject to taxation under Chapter 1 of the Internal Revenue Code of 1954.

On the facts as stated, the Tax Court held that petitioner "on the record date prescribed by the declaration of the dividend in question . . . had no interest in American's General stock, beneficial or otherwise", and accordingly was not entitled to its claimed dividends-received deduction with respect to the $31,800 payment on January 26, 1955. The Tax Court premised its holding on its view that the December 1954 contract for the purchase of American's General stock was "executory" until January 11, 1955 when the "no-action" letter of the Securities and Exchange Commission was issued and that "neither party [to the contract] was bound" until that date.

Petitioner here concedes that "in the case at bar the contract was conditional" but contends that since it "was ultimately carried out, in accordance with its terms, the fact that it was originally conditional in nature is wholly immaterial for all purposes."

The respondent Commissioner, in reply, asserts that the Tax Court correctly decided that petitioner was not the beneficial owner of the General stock on the dividend record date in 1954.

On review of the record we are of the opinion that the Tax Court did not err in its disposition.

It may be stated preliminarily that we are assuming, as the Tax Court did, "that Sutro in negotiating with American for the purchase of General stock was acting as petitioner's agent" even though the agreement of December 7, 1954 between Sutro and American preceded by 15 days petitioner's incorporation on December 22, 1954.

The agreement of December 7, 1954 for the sale by American of its 53,000 shares of its General stock to Sutro was provisional in that it provided:

> "If a 'no action' letter is not received from the Securities Exchange Commission on or before December 28, 1954, and if a registration statement as aforesaid with respect to these securities fails to become effective on or before April 15, 1955, this agreement shall become ineffective and there shall be no further rights or liabilities on the parts of either of us because of the transaction covered hereby."

The letter spelled out American's commitment to sell to Sutro its 53,000 shares of General stock *only* if the Securities and Exchange Commission gave its "no-action"

letter or, in the alternative, made effective a registration statement to be filed by General.

That being so, the agreement to sell—and buy—was based on a contingency which might never have materialized, and such an agreement does not vest any rights—beneficial or otherwise—until the materialization of the contingent event. It follows that petitioner's contention that it was vested with a beneficial interest in American's General stock prior to the Securities and Exchange Commission's "no-action" letter of January 11, 1955 is without merit. It was only on the latter date that a beneficial interest was vested in American's General stock in petitioner (via Sutro) and accordingly it was not entitled to payment of the dividends accruable to stockholders of record or beneficial owners, on December 20, 1954.

American on December 20, 1954 was the beneficial as well as the legal owner of its General stock and it alone was entitled to the dividends-received deduction provided by the relevant sections of the Internal Revenue Code of 1954 earlier cited.

The circumstance that the terms of the December 7, 1954 letter provided that "all dividends paid or payable on the said stock after the date hereof shall be your property and shall be paid over at the time of the purchase price . . ." is immaterial to the resolution here of the issue as to the application of the "dividends-received" deduction under the 1954 Code. The hard fact is that what the petitioner here labels a "dividend" was actually an allowance in reduction of cost of stock.

On this score, what was said by Judge Goodrich, speaking for this Court in Bakers' Mutual Cooperative

Ass'n v. Commissioner of Internal Revenue, 117 F. 2d 27 (1941) at page 28 is pertinent here:

> "We think it perfectly clear that the money paid out to the holders of these certificates is not to be classed as interest but dividends. What the parties have called the certificates or the payments is not, of course, controlling. They have not used their terms as terms of art, and, even if they had, the legal conclusion to be drawn from them is for the court."[3]

It merits observation that, as disclosed by American's letter to petitioner's counsel of January 18, 1955, when Sutro made settlement with American for the General stock it paid only $1,028,000 against the agreed $1,060,000 purchase price—an adjustment in price of $31,800. Further, as earlier stated, American, in its 1955 income tax return, reported the proceeds of the sale as being $1,028,000, treating the $31,800 at issue here as *an adjustment of** the sale price of the stock.

It may be stated, in conclusion, that we have found the cases cited by petitioner inapposite.

For the reason stated the Decision of the Tax Court will be affirmed.

A True Copy:

Teste:

Clerk of the United States Court of Appeals for the Third Circuit

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[3] See also John Kelley Co. v. Commissioner of Internal Revenue, 326 U.S. 521, 524-26 (1946).

* [Note: This opinion was amended to include the insertion of this phrase.]